STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Independent Telephone Association	**:**	
	:	
Petition requesting an Emergency Order	**:**	**Docket No. 01-0808**
with regard to Intrastate Access Charges	**:**	
of Incumbent Local Exchange Carriers	**:**	
serving 35,000 or fewer Access Lines	**:**	

INITIAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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TABLE OF CONTENTS

The Staff of the Illinois Commerce Commission (the "Staff"), by and through its counsel, and pursuant to Section 200.800 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Initial Brief in the above-captioned matter.

I. Procedural History

On December 14, 2001, the Illinois Independent Telephone Association (hereafter "IITA") filed its *Petition for Emergency Relief* in the above-captioned matter. *See, generally*, IITA Petition. In its Petition, the IITA stated, in summary, that the FCC has recently enacted new requirements regarding the manner in which small, high-cost companies of the kind represented by IITA recover access charges. Specifically, the IITA asserted that new federal requirements, embodied in what it described as the *MAG Orders*, shift non-traffic sensitive costs of local switch line ports to the common line category. IITA Petition, ¶¶3, 6-7. The IITA submitted that Commission Orders requiring that Illinois LECs "mirror" federal rate structure and rate levels on the state level, combined with this change in federal requirements, are likely to affect IITA member companies' revenues in a significant and adverse manner. IITA Petition, ¶¶3, 6-8. The IITA urged the Commission to enter an order directing ILECs with 35,000 or fewer access lines – the majority of which are IITA members – to file intrastate access tariffs pursuant to the Emergency Order to be effective January 1, 2002, mirroring all *MAG Orders'* interstate access rate elements except the local switching rate. IITA Petition, ¶13. The IITA further argued that intrastate local switching rate be adjusted and set so as to make the effect of the *MAG Orders* "revenue neutral" for the IITA companies' intrastate access revenues. Id.

In the alternative, the IITA requested that the Commission enter an Emergency Order, without hearing, prior to December 31, 2001 directing that intrastate access rates of all ILECs serving 35,000 or fewer access lines be frozen at existing levels until further order of the Commission. IITA Petition, ¶14. This, the IITA asserted, would insulate IITA companies from the adverse effects of the *MAG Orders* set forth above, and would allow for "a thoughtful and reasoned investigation of how intrastate access charges for companies with 35,000 or fewer access lines should be set on a going forward basis." Id.

On December 28, 2001, the Commission, after considering the IITA Petition and the parties' and Staff's responses thereto, entered an order imposing an interim freeze on access rates. Interim Order at 6. Contemporaneously, the Commission further directed the Staff to prepare a Staff Report, setting forth its assessment of issues associated with determining the appropriate methodology for estimating intrastate access charges for small rural ILECs on a going forward basis.

On March 7, 2002, the Staff filed its Report. *See* Staff Report. Various parties, having previously intervened, filed Comments and Replies to Comments regarding the Staff Report. *See Comments and Replies to Comments* of the IITA; Illinois Bell Telephone Company (hereafter "SBC"); AT&T Communications of Illinois, Inc. (hereafter "AT&T"); Gallatin River Communications, L.L.C. (hereafter "Gallatin River"); Home Telephone Company (hereafter "Home"); Harrisonville

Telephone Company (hereafter "Harrisonville"); and Leaf River Telephone Company (hereafter "Leaf River").

Thereafter, the various parties took part in discussions regarding the appropriate scope of, and issues to be addressed in the course of, this proceeding. Based upon these discussions, and having consulted with interested parties, the Staff prepared a Draft Scoping Order, which the Administrative Law Judge entered on September 13, 2002. *See* Administrative Law Judge's Scoping Order (September 13, 2002). Pursuant to a predetermined schedule, the IITA filed its Direct Testimony on October 25, 2002, and New Windsor its Direct Testimony on October 29, 2002. Verizon filed its Direct Testimony on November 22, 2002, in advance of the scheduled date for filing. On December 5, 2002, the Staff, SBC, and AT&T each filed Direct Testimony. On December 18, 2002, the Staff, SBC, Verizon, AT&T and Leaf River each filed Rebuttal Testimony to one another. On January 10, 2003, IITA filed its Rebuttal Testimony. Hearings were held pursuant to notice on January 23, 2003, and the matter continued generally, a briefing schedule having previously been set.

II. Preliminary Legal Matters

A. Burden of Proof

A petitioner in an administrative proceeding has the burden of proof, and relief will be denied if he fails to sustain that burden. Hamwi v. Zollar, 299 Ill. App. 3d 1088, 1092-93; 702 N.E.2d 593; 234 Ill. Dec. 253 (1st Dist. 1998). Indeed, the Illinois Supreme Court has gone so far as to state "courts have **uniformly** imposed on administrative agencies the customary common-law rule that the moving party has the burden of proof." Scott v. Dept. of Commerce and Community Affairs, 84 Ill. 2d 42, 53; 416 N.E.2d 1082 (1981) (emphasis added).

This is entirely consistent with Commission practice. In Commission proceedings, parties seeking relief must demonstrate that they are entitled to the relief sought. *See* Chicago and Eastern Illinois Ry. Co. v. Road Dist. No. 10, 353 Ill. 160, 166 (1933) (stating the burden is on the petitioner to show, by a preponderance of the evidence, that it is entitled to the relief sought).

IITA is self-evidently the petitioner here, and it and the supporters of its plan are the parties seeking relief, namely a Commission Order approving of the IITA plan to exclusion of others. Accordingly, they bear the burden of proof, with respect to demonstrating that relief is warranted at all, and also with respect to with respect to demonstrating that the Commission should adopt the IITA plan[1].

B. Standard of Proof

Section 10-15 of the Illinois Administrative Procedure Act provides that "[u]nless otherwise provided by law or stated in the agency's rules, the standard of proof in any contested case hearing conducted under this Act by an agency shall be the preponderance of the evidence." 5 ILCS 100/10-15. The Commission has observed that the Administrative Procedure Act standard appears to be "the appropriate standard in all contested cases[.]" *Order* at 4, Illinois Commerce Commission on its Own Motion: Amendment of 83 Ill. Admin. Code Part 200, ICC

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1 The IITA's proposal in this proceeding is referred to variously as "IITA plan", IITA proposal", or "IITA proposed methodology", in each with the same meaning.

Docket No. 92-0024 (April 29, 1992). Consequently, the standard of proof in this case is the preponderance of the evidence standard.

III. The *MAG Orders*

On November 8, 2001, the FCC released its *Second Report and Order* and *Further Notice of Proposed Rulemaking* in CC Docket No. 00-256 ("Rate of Return Access Charge Reform Order"). *See, generally*, *Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166*, In the matters of: Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation; Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, FCC No. 01-0304 (November 8, 2002)(hereafter "First MAG Order"). The *First MAG Order* imposed several significant requirements upon small rural carriers. Most significantly, it required such carriers to reduce their interstate access rates to cost-based levels. First MAG Order, ¶¶76-77. This was to be accomplished by, among other things, removing non-traffic sensitive costs from traffic-sensitive rates. Id, ¶¶17, 76, 79. Most significantly, for purposes of this proceeding, the FCC required that line port costs be reallocated from local switching to the common line category. Id., ¶90.

The relevant provisions of the *First MAG Order* are as follows:

In this section, we adopt measures to reform the access rate structure for local switching and transport services of rate-of-return carriers. In particular, we reallocate the non-traffic sensitive costs of local switch line ports to the common line category, and reallocate remaining costs contained in the TIC [transport interconnection charge] to other access rate elements. Together with our actions to reform the common line rate structure, these measures will foster competition and efficient pricing and move the per-minute switched access rates of rate-of-return carriers towards lower, cost-based levels. We do not adopt proposals by the MAG and others to prescribe a single, target rate for rate-of-return carriers, either on an optional or a mandatory basis.

First, we address the MAG proposal to prescribe a target rate of 1.6 cents for the per-minute switched access rates of Path A pooling carriers, and alternative proposals to prescribe a mandatory .95-cent target rate for all rate-of-return carriers. For the reasons set forth below, we conclude that these proposals are not supported by cost data and that the non-prescriptive, market-based approach to access charge reform that we adopt is more consistent with the competitive and universal service goals of the 1996 Act. We then address reallocation of local switch line port costs and the costs contained in the TIC, respectively. Finally, we address other pending Commission proposals to modify the local switching and transport rate structure.

First MAG Order, ¶¶76-77 (footnotes omitted)

The MAG's CAR [Composite Access Rate] proposal does not address inefficiencies in the existing rate structure of rate-of-return carriers, focusing instead exclusively on rate level concerns. Thus, line port costs are not addressed and would continue to be recovered through traffic sensitive rates, although they are non-traffic sensitive in character. The MAG's CAR proposal also would retain a TIC rate element, albeit presumably at a lower rate than the present TIC rate. By reallocating line port costs and the TIC instead, we align the rate structure more closely with the manner in which costs are incurred, consistent with longstanding Commission goals.

First MAG Order, ¶79 (footnotes omitted).

We adopt the Commission's proposal from the *1998 Notice* to modify the access rate structure for rate-of-return carriers by reallocating line port costs from local switching to the common line category. To ease the burden of implementing this rate structure modification on small rate-of-return carriers, we will permit them to shift 30 percent of their local

> switching costs to the common line category in lieu of conducting a cost study.
>
> First MAG Order, ¶90

The remaining *MAG Orders*, of which there are several, are generally procedural in character, concerning themselves largely with the dates by which affected companies must file compliant tariffs. However, these *Orders*, along with the *First MAG Order*, will be referred to collectively herein as the *MAG Orders*.

IV. Argument

The Commission should not adopt the IITA proposal in this proceeding. The IITA proposes to address the *MAG Orders* in two steps. Under the first step the IITA recommends the Commission order that the intrastate access rate structure mirror the interstate access rate structure set in the MAG orders, with the exception of the local switching rate. The local switching rate would then be adjusted in such a manner that the new rate for local switching would recover the revenue lost through mirroring the other MAG rate elements. Under the second step, each IITA company would file, every year or alternate years, an analysis of its total company revenue requirement for the prior year. IITA Ex. 1.0 at 30. A federal revenue requirement would then be set. IITA Ex. 1.0 at 32-4. Each company would subsequently derive a state revenue requirement by subtracting the federal revenue requirement from the total revenue requirement. IITA Ex. 1.0 at 33-4. Finally, state revenues from various sources would be subtracted from the state requirement. Id. These revenue sources would include revenues from local service, subscriber line charges, state high cost support, federal loop support, and miscellaneous revenues, as well as imputed revenue increases or decreases resulting from the phase-in of the state high cost fund, and increases or decreases in state high cost funding resulting from other changes. Id. Each company would then recover any remaining portion of its state revenue requirement by increasing rates for local switching. Id.

The IITA proposal is inconsistent with rational economic pricing and deviates from long-standing FCC and Commission policies in that it (1) improperly shifts the recovery of non-traffic sensitive costs from two traffic sensitive rate elements (e.g. tandem switching and tandem transport) to another traffic sensitive rate element (local switching) rather than moving recovery of non-traffic costs to a non-traffic sensitive rate element (i.e., basic local rates); (2) causes rates for local switching to move away from their underlying costs; and (3) is not truly revenue neutral, but rather will "compensate" IITA carriers for *any* intrastate revenue shortfall they might report, well in excess of the effect of mirroring the MAG Orders.

Instead, the Commission should adopt the Staff's proposal of imposing a state subscriber line charge to make the small carriers whole with respect to mirroring the *MAG Orders*. The Staff's proposal is fully consistent with FCC and Commission policies, is economically rational, and will be simple to implement.

A. The Commission Should Not Adopt the IITA Plan

1. The IITA Plan Improperly Shifts Recovery of Non-Traffic Sensitive Costs from one Traffic Sensitive Rate to another Traffic Sensitive Rate

In its *First MAG Order*, the FCC noted that:

> The Commission has long recognized that, to the extent possible, interstate access costs should be recovered in the manner in which they are incurred. **In particular, non-traffic sensitive costs—costs that do not vary with the amount of traffic carried over the facilities—should be recovered through fixed, flat charges, and traffic sensitive costs should be recovered through per-minute charges**.

First MAG Order, ¶17 (emphasis added; footnote omitted)

Consistent with this long-standing policy, the FCC summarized its ruling in the *First MAG Order* with respect to local switching as follows:

> [W]e adopt measures to reform the access rate structure for local switching and transport services of rate-of-return carriers. [fn] In particular, **we reallocate the non-traffic sensitive costs of local switch line ports to the common line category, and reallocate remaining costs contained in the TIC to other access rate elements.** Together with our actions to reform the common line rate structure, **these measures will foster competition and efficient pricing and move the per-minute switched access rates of rate-of-return carriers towards lower, cost-based levels.** We do not adopt proposals by the MAG and others to prescribe a single, target rate for rate-of-return carriers, either on an optional or a mandatory basis.

First MAG Order, ¶76 (emphasis added; footnote omitted)

The goal of allocating non-traffic sensitive costs to non-traffic sensitive rate elements is reiterated thereafter, the FCC noting that:

> The MAG's CAR [Composite Access Rate] proposal does not address inefficiencies in the existing rate structure of rate-of-return carriers, focusing instead exclusively on rate level concerns. [fn] **Thus, line port costs are not addressed and would continue to be recovered through traffic sensitive rates, although they are non-traffic sensitive in character.** The MAG's CAR proposal also would retain a TIC rate element, albeit presumably at a lower rate than the present TIC rate. [fn] **By reallocating line port costs and the TIC instead, we align the rate structure more closely with the manner in which costs are incurred, consistent with longstanding Commission goals**.

First MAG Order, ¶79 (emphasis added; footnotes omitted).

Finally, the FCC elected to:

> … adopt the Commission's proposal from the *1998 Notice* to modify the access rate structure for rate-of-return carriers **by reallocating line port costs from local switching to the common line category**. To ease the burden of implementing this rate structure modification on small rate-of-return carriers, we will permit them to shift 30 percent of their local switching costs to the common line category in lieu of conducting a cost study.
>
> First MAG Order, ¶90

All of these findings indicate that the FCC intended, as Staff witness Dr. Staranczak notes, *see* Staff Ex. 1.0 at 2-4, to shift recovery of non-traffic sensitive costs from local switching to the common line category, which is to say from traffic-sensitive rate elements to non-traffic sensitive ones. Likewise, the FCC clearly stated that non-traffic sensitive costs should be moved out of the local switching rate. First MAG Order, ¶¶76, 79.

The IITA's proposal would effectively negate the FCC's actions in the *First MAG Order*. The IITA plan, as noted above, not only moves cost recovery from one traffic sensitive rate element to another, but also moves that recovery from other elements to the local switching rate. In other words, the IITA proposal is essentially an attempt to undo the *MAG Orders*.

The IITA proposal flies in the face of FCC policy, but this is not its only failing. *This* Commission's policies regarding cost recovery are virtually identical to those articulated by the FCC in the *MAG Orders*, and as a result the IITA proposal would subvert long-standing Illinois policies as well. In its *Twenty-Seventh Interim Order* in Docket No. 83-0142, the Commission "recogniz[ed] that the traffic sensitive collection of NTS related costs is inappropriate…[.]" *Twenty-*

Seventh Interim Order at 4, Illinois Commerce Commission on its Own Motion: Investigation concerning the appropriate methodology for the calculation of intrastate access charges for all Illinois telephone utilities, ICC Docket No. 83-0142 (October 16, 1986) (hereafter "Twenty-Seventh Interim Order"). The Commission further found that the stipulation at issue in the proceeding "promotes the Commission's ultimate goals of cost-based pricing." Twenty-Seventh Interim Order at 5. In addition, as the Commission observed, "it is appropriate to continue the Commission's current policy of not assigning NTS costs to intra-MSA switched access toll services[2][.]" Id. In other words, it was this Commission's policy as early as 1986[3] to require access rates to move towards cost, and to accomplish this, in part, by moving the recovery of non-traffic sensitive costs out of traffic-sensitive rate elements.

In its *Forty-Sixth Interim Order* in Docket No. 83-0142, the Commission expanded upon this policy. *See, generally*, *Forty-Sixth Interim Order*, Illinois Commerce Commission on its Own Motion: Investigation concerning the appropriate methodology for the calculation of intrastate access charges for all Illinois telephone utilities, ICC Docket No. 83-0142 (December 13, 1989) (hereafter "Forty-Sixth Interim Order"). It noted, in the prefatory portion of the *Order*, that the goal of the proceeding generally had been to "provide a transitional mechanism for the transfer and recovery of the frozen 1984 loop non-traffic sensitive ('NTS') revenue requirements from customers of interexchange

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2 Toll service is, perhaps obviously, traffic sensitive.

3 The Commission adopted its policy of mirroring in the *Fourth Interim Order* in Docket No. 83-0142. *See* Access Charge Order at 35 (The cited section of the *Access Charge Order* contains a useful history of Commission orders and policies with respect to this issue).

carriers ('ICs') to the cost causing end users." Forty-Sixth Interim Order at 1; *see also* Appendix A, Forty-Sixth Interim Order, ¶1. To accomplish this goal, the Commission directed that small "cost" ILECS either mirror their current interstate access tariffs at the intrastate level, or continue to mirror 1987 interstate rates for local switching elements. Forty-Sixth Interim Order at 3; *see also* Appendix A, Forty-Sixth Interim Order, ¶6. So-called "average schedule" companies were to mirror 1987 interstate rates for local switching elements, and to report to the Commission by 1991 regarding their evaluation and determination of a basis for developing an intrastate access rate[4]. Id.; *see also* Appendix A, Forty-Sixth Interim Order, ¶7.

More recently, the Commission directed Ameritech Illinois and Verizon to file cost based access charge rates. *Order* at 118, Illinois Commerce Commission On Its Own Motion vs. Illinois Bell Telephone Company; *et al*., Investigation into Non-Cost Based Access Charge Rate Elements in the Intrastate Access Charges of Incumbent Local Exchange Carriers in Illinois; Illinois Commerce Commission On Its Own Motion, Investigation into Implicit Universal Service Subsidies in Intrastate Access Charges and to Investigate how these Subsidies should be Treated in the Future; Illinois Commerce Commission On Its Own Motion, Investigation into the Reasonableness of the LS2 Rate of Illinois Bell Telephone Company, ICC Docket Nos. 97-0601; 97-0602; 97-0516

[4] The "average schedule" companies duly produced such a report. *See, generally*, *First Interim Order*, Illinois Commerce Commission on its Own Motion: Investigation concerning access charges, the administration of the High Cost Fund, administration of the Illinois Small Carrier Association, and other telecommunications issues, ICC Docket No. 90-0425 (May 29, 1991) (hereafter "First Interim Order").

(consol.) (March 29, 2000) (hereafter "Access Charge Order"). There, the Commission stated that:

> One of the long-standing goals of this Commission has been to promote movement toward a pricing methodology for telecommunications services under which the rates charged for services reflect the way in which the costs to provide those services are incurred. **To that end, we have made substantial efforts over the last decade to prohibit the recovery of non-traffic sensitive costs through traffic sensitive intrastate access charges. By eliminating the recovery of NTS costs from usage sensitive rates, we have been able to curtail the subsidization of non-traffic sensitive costs associated with the carrier common line, or CCL, with revenues from usage sensitive access charges.** This is in accordance with a concept that has been approved in numerous prior Commission orders: the party who causes the costs to be incurred should pay those costs.
>
> Access Charge Order at 34-35 (emphasis added)

Consistent with this, the Commission noted that its *Orders* in Docket No. 83-0142 "specifically provided that no LEC would be permitted to recover non-traffic sensitive line port revenues via usage sensitive access charges from IXCs." Access Charge Order at 37.

The IITA proposal simply cannot be reconciled with these Commission policies and orders, and indeed violates a number of them. It would, if adopted, result in precisely what the Commission prohibited in the *Access Charge Order* and numerous previous *Orders*: namely, recovery from IXCs of non-traffic sensitive revenues through usage-sensitive access charges. Likewise, and related, it violates the long-standing Commission policy that the person who causes costs ought to pay them. Non-traffic sensitive costs are attributable to the common line; as the Commission noted in the *Access Charge Order*, "curtail[ing] the subsidization of non-traffic sensitive costs associated with the carrier common line, or CCL, with revenues from usage sensitive access charges … is in accordance with a concept that has been approved in numerous prior Commission orders: the party who causes the costs to be incurred should pay those costs." Access Charge Order at 35. It is clear from this that the Commission finds non-traffic sensitive costs to be caused by the end user of the subscriber line, and considers the end user to be properly charged with those costs, rather than IXC customers, as the IITA would have it.

It is clear from the forgoing that the IITA plan cannot be adopted consistent with long-standing FCC and Commission policy regarding the recovery of non-traffic-sensitive costs. It appears to be little more than an attempt to avoid the effect of FCC policies and orders, by violating Commission polices.

Finally, rational economic pricing prescribes that non-traffic sensitive costs be recovered from non-traffic sensitive rate elements. Under the IITA proposal, non-traffic sensitive common costs would be recovered from the traffic sensitive local switching rate. The IITA proposal is therefore inconsistent with cost based pricing. Accordingly, it should be rejected.

2. The IITA Plan Moves Intrastate Local Switching Rates Away From Cost

The IITA proposal also moves intrastate local switching rates away from, rather than towards, their economic costs. As previously noted, such rates will, under the IITA proposal, increase (aggregated throughout IITA companies) by between $2.3 million and $3.8 million. IITA Ex. 1.0 at 14. As the FCC noted in the *First MAG Order*, the MAG group provided no cost information that would tend to support any increase to local switching rates. First MAG Order, ¶77. Likewise, the IITA has shown none here. *See, generally*, IITA Ex. 1.0, 2.0. The increase is not justified in any way except by the fact that it purports to make IITA carriers whole from the effects of mirroring. IITA Ex. 1.0 at 24, 29-30, 35.

Such an outcome is diametrically opposed to both the FCC's, and this Commission's, policy of moving access rates towards cost. In furtherance of this policy, the Commission has required non-rural ILECs to eliminate all non-cost based rate elements from their access rates. *Access Charge Order* at 118; *see also* Staff Ex. 1.0 at 9 ("The Commission held in [the *Access Charge Order*], and Staff believes, that intrastate access rates should be based on the costs of providing intrastate access"). Likewise, the FCC's *MAG Order* seeks to move access rates towards cost. *See, e.g.,* First MAG Order, ¶76 ("[The] measures [the FCC adopts in the *First MAG Order*] … move the per-minute switched access rates of rate-of-return carriers towards lower, cost-based levels[.]")

The IITA's proposal, in contrast, clearly moves these rates *higher*, *away* from cost-based levels. See Tr. at 175-76 (IITA witness Robert Schoonmaker states that most small companies would increase these rates under the IITA proposal). In addition, the IITA plan proposes to *raise* on the *intrastate* side the very same rates as the FCC has ordered *lowered* in the *interstate* side. In other words, the IITA proposal is inconsistent with the policy underlying the *MAG Orders*. Accordingly, it cannot be adopted.

3. The IITA Plan Is Not Revenue Neutral

Finally, the IITA proposal, which purports to be revenue neutral, is not in fact anything of the sort. As noted above, the IITA proposes that, once an intrastate revenue requirement is set, actual intrastate revenues are subtracted to yield a so-called "remaining requirement." IITA Ex. 1.0 at 34. Intrastate revenues, according to the IITA, include "local revenues, state subscriber line charges, state high cost support funds, federal high cost loop universal service funds, and miscellaneous revenues." IITA Ex. 1.0 at 33.

Under the circumstances that exist in Illinois, this will not result in revenue neutrality, but instead will enable IITA carriers to recover revenue shortfalls <u>over and above</u> those caused by mirroring the *MAG Orders*. In its *Second Interim Order on Rehearing* in Docket No. 00-0233/0335, the Commission determined that IITA subscribers' <u>second</u> lines were ineligible for state universal service support. *Second Interim Order on Rehearing* at 22-23, <u>Illinois Independent Telephone Association: Petition for initiation of an Investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act / Illinois Commerce Commission On Its Own Motion: Investigation into the necessity of and, if appropriate the establishment of a universal support fund pursuant to Section 13-301(d) of the Public Utilities Act</u>, ICC Docket Nos. 00-0233/0335 (consol.) (March 13, 2002). There, the Commission found that:

> The Commission has reviewed the evidence and arguments of the parties and concludes that it should not depart from the decision reached previously, which would base the [state Universal Service Fund] calculation on support for a primary line, whether that line be business or residential. The Commission notes that while the parties have presented a great deal of evidence and argument relating to this issue, no party has

> presented any matter that was not previously before the Commission at the time of the entry of the Second Interim Order. **At the time we reached the single line determination there, we were cognizant of the fact that basing the size of the USF fund on support for a single line would reduce the fund size. We were also cognizant of the fact that the qualifying companies would, in all likelihood, seek to recoup the reduction in the fund size from their customers. Rate increases are particularly likely in light of the fact that we have little or no control over the rates charged by the qualifying companies under Section 13-504 of the PUA, which largely exempts carriers with less than 35,000 access lines from the rate making provisions of Article IX of the PUA.**
>
> Despite the fact that our decision here may bring rate increases to the customers of the qualifying companies, the policy issue is more far reaching. **The policy issue facing the Commission is whether the families and agencies, and, in the case of public agencies, the taxing agencies that support them, should bear the brunt of increased rates relating to second lines, or whether the burden should be shifted to all citizens of the state, including low income citizens in inner cities that cannot afford a single line.** On balance, reasoned public policy supports imposing the burden on the parties who use the services and the localities where they are used rather than allowing parties to purchase second lines on the backs of the poor.
>
> Second Interim Order on Rehearing at 22 (emphasis added)

IITA member companies, however, have chosen not to increase non-primary line rates to levels that would meet their revenue requirements. Staff Ex. 1.0 at 8. Accordingly, the IITA companies' "remaining requirement" will include revenues that the IITA companies will not recover from the state universal service fund, and have unilaterally *decided* not to recover from second-line subscribers. These unrecovered revenues will, under the IITA's proposal, be recovered through the local switching rate. *See* Tr. at 177-78 (Mr. Schoonmaker agrees that this is the case); *see also* AT&T Ex. 1.00 at 7 (AT&T witness Cate Hegstrom points out that the IITA proposal uses the local switching rate as a vehicle to permit IITA companies to earn a predetermined rate of return, notwithstanding other Commission and FCC orders).

As noted above, in its *Second Interim Order on Rehearing*, the Commission determined that IITA customers with second lines ought not to receive a subsidy for those second lines from other subscribers elsewhere in the state. However, the IITA's proposal would, if adopted, negate that determination, since all revenues that carriers fail – or, in this case, do not choose – to recover from their multi-line subscribers will be recovered through the intrastate local switching rate. *See* AT&T Ex. 1.00 at 8 (Ms. Hegstrom notes that the IITA proposal appears to be an "end run" around the Commission's decision not to subsidize second lines). In other words, the IITA's proposal merely transfers the subsidization of IITA customers' second lines from all ratepayers, to the very large number of Illinois ratepayers who make telephone calls requiring exchange access service[5]. Interexchange carriers and their subscribers would in effect be taxed[6] in order to subsidize IITA subscribers who have more than one line. Staff Ex. 1.0 at 9. In addition, this subsidy would be implicit, rather than explicit, an outcome which sound policy deplores, *see* Staff Ex. 1.0 at 9-10, and of which the Illinois General Assembly disapproves. *See* 220 ILCS 5/13-301(e)(2)(The General Assembly directs the Commission, when the latter establishes a state

[5] Were such a subsidy found to be in the public interest – which, of course, it has not been – collecting it from all Illinois customers would be the preferred outcome, inasmuch as the tax should be broadly, rather than narrowly based. Staff Ex. 1.0 at 9-10. If preventing non-primary line rates for IITA member companies from rising above primary line rates is considered to be in the public interest, then all subscribers in the state should finance this goal, not just interexchange carriers and their subscribers. Id.

[6] The word "tax" is used here in its economic sense, rather than in its government - fiscal policy sense.

universal service fund, to "[i]dentify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund[.]")

In summary, since the Commission ordered that subsidies for second lines be discontinued altogether, the IITA proposal must be rejected to the extent that it allows such subsidies to not only continue to exist, but to do so in a manner inconsistent with sound public policy regarding subsidies.

Moreover, since <u>all</u> intrastate revenue shortfalls – of <u>any</u> description – will apparently find their way into the "remaining requirement" and hence into the intrastate local switching rate, the IITA proposal will do far more than compensate for the results of intrastate "mirroring" of the *MAG Orders*. Indeed, it will "compensate" IITA companies for <u>any</u> intrastate revenue loss, of any description whatever. *See* AT&T Ex. 1.00 at 9-10 (IITA proposal would, among other things, permit IITA carriers to recover, <u>through</u> access charges, carrier common line charges that the Commission has specifically <u>removed</u> from access charges). Again, this alone prevents its adoption.

This proceeding should focus on whether the Commission ought to mirror the *MAG Orders*, and if it elects to mirror, how any revenue shortfall from mirroring and only mirroring be made up. Staff Ex. 1.0 at 7. The Commission should not expand the scope of this docket to address the revenue shortfalls that small companies claim to exist, but which, if they do indeed exist, have nothing whatever to do with mirroring. Revenue requirement issues should not be addressed in this proceeding. Id.

The IITA proposal is gravely – indeed, irremediably – flawed. It runs directly contrary to a number of well-articulated and long-standing Commission and FCC policies regarding moving access rates towards cost and assessing non-traffic sensitive costs through non-traffic sensitive rates. In addition, it seeks to avoid the effects of the *MAG Orders* and the Commission's *Second Interim Order on Rehearing*. As Dr. Staranczak notes, the IITA proposal is advanced without underlying economic or policy rationale. Staff Ex. 1.0 at 5. The IITA has not articulated a convincing reason why its approach is an improvement over the status quo, or other mirroring proposals, Id. at 5-6, which, as petitioner, it has the burden of showing. Indeed, it appears to offer no advantages whatever, other than those accruing to IITA carriers. The Commission should soundly reject it.

B. The Commission Should Adopt a Revenue Neutral Solution

Notwithstanding the numerous defects in the IITA proposal, most of the parties to this proceeding agree that, whatever other effects the *MAG Orders* might have, they ought to be revenue neutral as to the IITA carriers. *See* Staff Ex. 1.0 at 14; IITA Ex. 2.0 at 10 (indicating that the Staff, Verizon, Ameritech and the IITA favor revenue neutrality); New Windsor Ex. 1.0 at 5 (New Windsor witness Gordon Kraut favors IITA's position); Leaf River Ex. 1.0 at 21 (Leaf River witness Michael Petrouske favors IITA's position).

The Commission should adopt a policy of revenue neutrality with respect to the *MAG Orders*. Staff Ex. 1.0 at 14. If explicit Commission action (in response to the *MAG Orders*) reduces the revenues of small companies, then the Commission should provide a means for these small companies to recoup the revenue lost because of this action for reasons of fairness. Staff Ex. 2.0 at 6. At the federal level, the *MAG Orders* are intended to be revenue neutral for the companies affected. Staff Ex. 1.0 at 4; *see also, generally,* <u>First MAG Order</u>, ¶120 *et seq*. Reductions in interstate access charges were made up by increases in the subscriber line charge and by other means of support. <u>First MAG Order</u>, ¶128 *et seq*. Mirroring the MAG orders at the state level, therefore, should be interpreted to also mean mirroring the federal policy of revenue neutrality. Staff Ex. 1.0 at 15. Furthermore, if any form of mirroring is adopted, then mirroring and the means to recover any revenue lost through mirroring should occur simultaneously. Tr. at 233.

Alone among the parties presenting testimony, AT&T does not advocate revenue neutrality, but nonetheless supports "if appropriate," a one-time, revenue neutral, offset of revenue losses from mirroring the elimination of the transport interconnection charge ("hereafter "TIC"). AT&T Ex. 1.00 at 9-11.

AT&T advances two bases for opposing revenue neutrality as to revenues lost through mirroring the interstate local switching rate. First, AT&T argues that the Commission did not permit SBC or Verizon to recover revenues they lost when the Commission ordered those companies to reduce their access charges in the *Access Charge Order*. AT&T Ex. 1.00 at 10. Second, AT&T contends that methods used to estimate common line category revenues and costs for small companies are inaccurate and inherently suspect. Id. at 13-14. Related to this point, AT&T argues that the impact of mirroring is difficult to assess, inasmuch as local switching rates for one group of small companies appear to be something of a moving target, having changed three times in eighteen months. Id. at 14. This being the case, AT&T recommends that the Commission ignore this impact altogether. Id.

AT&T's arguments should be rejected, largely on pragmatic grounds. While it is undoubtedly true that the Commission rejected SBC's and Verizon's arguments that the *Access Charge Order* ought to be revenue neutral, comparison of these companies to IITA companies is entirely inapposite. As Dr. Staranczak points out, the financial circumstances that Verizon and SBC faced at the time of the *Access Charge Order* are substantially different from the financial circumstances the small companies face in the current proceeding. Staff Ex. 2.0 at 6. Dr. Staranczak notes that Verizon has not subsequently attempted to recoup those revenues through the filing of a rate case, Id. at 6-7, and further notes that SBC was, at all relevant times, subject to price cap regulation pursuant to Section 13-506.1 of the Public Utilities Act, 220 ILCS 5/13-506.1, rendering rate of return questions academic in its case[7]. Staff Ex. 2.0 at 7, n.1.

The IITA companies are differently situated. There seems to be little dispute, even from AT&T, that there will be an adverse financial impact upon the small companies in the aggregate, and that such impact is certain to be, from the

[7] As Dr. Staranczak also notes, SBC has done well for itself under alternative regulation, increasing its rate of return on common equity. Staff Ex. 2.0 at 7, n.1.

perspective of the small companies, not insubstantial. To the extent that AT&T raises questions regarding this issue, these questions relate not to the existence of an adverse impact, but rather to the quality of the data used to determine its size.

Accepting for the sake of argument that there is indeed a problem in determining the financial impact of mirroring, it is scarcely an insuperable one. As Dr. Staranczak points out, the Commission can decide on the vintage of interstate local switching rates it will use to mirror. Staff Ex. 2.0 at 8. Once this is done, companies that lose revenue from mirroring the rates determined to be proper by the Commission will be compensated for revenues they lose as a result. Id. In light of the circumstances, fairness demands as much. Id.

Moreover, the Commission is familiar with the difficulties associated with ascertaining or modeling small companies' costs. As the Commission noted in its *Second Interim Order* in Docket Nos. 00-0233/0335 (consol.), neither the FCC nor the Commission have been able to develop suitable input values for the modeling of small companies' forward-looking costs. *Second Interim Order* at 18, Illinois Independent Telephone Association: Petition for initiation of an Investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act / Illinois Commerce Commission On Its Own Motion: Investigation into the necessity of and, if appropriate the establishment of a universal support fund pursuant to Section 13-301(d) of the Public Utilities Act, ICC Docket Nos. 00-0233/0335 (consol.) (September 18, 2001). The fact remains, however, that in this proceeding, the Commission can determine a good estimate of losses (or, in fairness, gains) resulting from mirroring. The fact that this estimate will perhaps be imperfect is a poor reason to contend, as AT&T appears to contend, that no estimate should be made or used.

Accordingly, the Commission should conclude that IITA carriers must somehow be made whole from the results of mirroring the *MAG Orders*. To the extent that the Commission accepts this proposition, it must implement a plan by which this can be achieved.

C. The Commission Should Continue its Long-Standing Policy of Mirroring

The Commission's policy, as articulated in its various orders in Dockets Nos. 83-0142 and 90-0425, has been to mirror interstate access rate changes initiated at the federal level. Staff Ex. 1.0 at 4. The Commission should continue its policy of mirroring, as defined by Scenario #3, Attachment 4.03 of Mr. Schoonmaker's direct testimony. Under Scenario #3, intrastate access rates would be set equal to the corresponding interstate access rate with the exception of the carrier common line (CCL) charge. Mirroring the interstate common line charge is inappropriate, because this charge is scheduled to be eliminated by July 2003, and it makes no sense to mirror a charge that does not currently exist at the state level and will soon cease to exist at the federal level. Staff Ex. 1.0 at 11.

The Commission should continue its policy of mirroring for two reasons. First, mirroring is administratively simple and logically sound. Setting intrastate access rates equal to interstate access rates is easy to implement. Staff Ex. 1.0 at 11. Moreover, since interstate access and intrastate access are essentially the same service, and consequently cost the same amount to provide, it is rational to charge the same rate for each service. Staff Ex. 1.0 at 11. Indeed, it would be irrational to do otherwise.

Second, mirroring makes economic sense. Staff Ex. 1.0 at 11. As noted above, the FCC intended in the *MAG Orders* to shift the recovery of non-traffic sensitive costs from traffic-sensitive rate elements such as the TIC to non-traffic rate elements such as the subscriber line charge. Staff Ex. 1.0 at 6. The Commission should adopt the same policy goal by moving the recovery of intrastate non-traffic sensitive costs from traffic sensitive intrastate access rates to non-traffic sensitive rate elements at the state level. Staff Ex. 1.0 at 11. Economic pricing principles dictate that subsidy (i.e. non-traffic sensitive cost) elements should be removed from intrastate access rates. Id. The Commission has recognized this principle in its *Twenty-Seventh Interim Order* when it removed non-traffic central office equipment charges from the intrastate local switching rate. Twenty-Seventh Interim Order at 4-5. There is no reason to depart from this long-standing policy, and a number of good reasons to adhere to it.

D. Any Revenue Shortfall Caused by Mirroring Should be Addressed through the Imposition of a Subscriber Line Charge or by Local Rate Increases

As noted above, mirroring the *MAG Orders* will cause some of the IITA carriers to experience a revenue shortfall to a greater or lesser degree, and, inasmuch as the Commission should adopt a policy of revenue neutrality with respect to such mirroring, some method of recovering the shortfall will have to be adopted. There are several competing proposals regarding how this can be achieved. The Commission should adopt the Staff's proposal, and order a state subscriber line charge.

The Staff recommends that any revenue shortfall that small companies may experience from mirroring the *MAG Orders* be recouped through the imposition of a new state subscriber line charge to be assessed to customers of companies subject to the *MAG Orders*. Staff Ex. 1.0 at 19. There are several excellent reasons for this.

First, imposition of a state subscriber line charge is consistent with the FCC's approach, in which small companies recouped much of the revenue lost from interstate access rate reductions through an increase in the federal subscriber line charge. Staff Ex. 1.0 at 19. Second, imposing a state subscriber line charge is consistent with economic principles, which suggest that non-traffic sensitive costs should be recovered from non-traffic sensitive rate elements. Staff Ex. 1.0 at 18.

Under the Staff's proposal, small carriers would forward revenues realized from the state subscriber line charge to a pool that would use the money collected to compensate member companies for any revenue shortfalls that may arise out of mirroring. The payments from the pool to individual member companies would be fixed for the life of the pool and would based on revenue shortfalls estimated from 2000 intrastate minute data. Payments to individual member companies would be made monthly. The pool would be administered by the Illinois Small Company Exchange Carrier's Association (ISCECA), which administers the state USF fund. Staff Ex. 2.0 at 4, 11-12.

The Staff originally proposed that the state subscriber line charge be set at $1.96 for average schedule companies and $1.83 for cost companies. Staff Ex. 1.0 at 19. However, if this arrangement is administratively burdensome, the Staff as an alternative recommends a single state subscriber line charge of $1.87 for all companies. Finally, if the Commission expressly orders the pooling arrangement, there are no double taxation issues, as alleged by other parties[8]. Staff - Schoonmaker Cross-Examination Ex. 1.0. Staff recommends October 1, 2003 as the implementation date for the state subscriber line charge.

If the Commission does not favor pooling, the Staff recommends in the alternative that IITA companies impose local rate increases to recoup any revenue shortfalls that arise from mirroring. Staff Ex. 1.0 at 17. Currently, small companies can file for local rate increases at any time on 30 days' notice, and these proposed increases do not require Commission approval unless 10% of each company's subscribers file a petition in opposition to the rate increase. 220 ILCS 5/13-504. Accordingly, the IITA carriers have <u>vastly</u> more flexibility to implement such increases than other carriers, since IITA carriers are in all cases either subject to Section 13-504, or are co-operatives or mutual concerns that are

8 *See, e.g.*, Leaf River Ex. 1.0 at 14-15.

even less subject to rate regulation by the Commission. *See* 220 ILCS 5/13-202(b) (Mutual concerns not "telecommunications carriers" within the meaning of the Public Utilities Act); *see also* 220 ILCS 5/13-701 (Co-operatives not subject to rate regulation by the Commission).

However, if the Commission adopts this option, it nonetheless should allow sufficient time for companies to file for local rate increase and conclude hearings on petitions, before implementing intrastate access rate changes. Staff Ex. 1.0 at 17. Again, Staff recommends October 1, 2003 as the target implementation date.

A local rate increase would accomplish many of the same policy goals that the Staff's preferred option, a state subscriber line charge, would. Implementing local rate increases would mean that non-traffic sensitive costs formerly recovered by intrastate access rates would be recovered by non-traffic sensitive basic service rates. Staff Ex. 1.0 at 18. Similarly, from a customer's point of view, both a local rate increase and a subscriber line charge would increase the amount the local subscriber has to pay for telephone service. Staff Ex. 1.0 at 18.

If the Commission does opt for local rate increases, the Staff recommends a two-year phase-in for companies that face an increase greater than in monthly rates that exceeds $2. Staff Ex. 2.0 at 8-9. During the first year, intrastate access rates would move halfway to full mirroring and local rates would be raised sufficiently to achieve revenue neutrality for the half mirroring that occurs during the first year. In the second year, intrastate access rates would move to full mirroring, and local rates would be increased again to achieve revenue neutrality. Staff Ex. 2.0 at 9.

Schedule 1, attached hereto and incorporated herein by this reference, details the proposed rate change for each company under Staff's proposed phase-in. *See* Schedule 1, *attached hereto*. Schedule 2, likewise attached hereto and incorporated herein by this reference, sets forth the intrastate access charge reductions consistent with the local rate changes Staff proposes in Schedule 1.

E. The Universal Service Proceeding Should Not Be Reopened for the Purpose of Increasing Small Carrier High Cost Support

Increased universal service subsidies are not in the public interest. Staff Ex. 2.0 at 3-5. The Commission has already determined how much Illinois subscribers should be charged in order to support the small companies; further increases in this surcharge are unwarranted. Staff Ex. 2.0 at 3. Nevertheless, the Staff recommends that the Universal Service Dockets be re-opened at such time as is convenient to examine whether wireless carriers should be required to contribute to the Universal Service Fund on the same basis as other carriers. Staff Ex. 2.0 at 5; SBC Ex. 1.0 at 20. Currently, intrastate services provided by wireline carriers are taxed to support the Universal Service Fund while similar services provided by wireless carriers are not. Staff Ex. 2.0 at 5. This provides a competitive advantage to wireless carriers when competing against both local and interexchange carriers. Id.; SBC Ex. 1.0 at 20. Such a competitive disadvantage does not exist at the federal level since both types of carriers contribute to the federal Universal Service Fund. Staff Ex. 2.0 at 5; SBC Ex. 1.0 at 20-21.

V. Conclusion

The Commission should not adopt the IITA proposal in the proceeding. The IITA proposal deviates from – and in fact is diametrically opposed to – long standing FCC and Commission policies in that it (1) improperly moves recovery of non-traffic sensitive costs into traffic-sensitive rates; (2) causes rates for local switching to move away from their underlying costs; and (3) is not truly revenue neutral.

Instead, the Commission should adopt a revenue-neutral solution, and more specifically should adopt the Staff's proposal of adopting a state subscriber line charge to make the IITA carriers whole. The Staff's proposal is fully consistent with FCC and Commission policies, is economically rational, and will be simple to implement.

WHEREFORE, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in their entirety consistent with the arguments set forth herein.

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Respectfully submitted,

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